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RUEHBK/AMEMBASSY BANGKOK 3710
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RUEHUL/AMEMBASSY SEOUL 8690
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RUEHKL/AMEMBASSY KUALA LUMPUR 3751
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TREASURY FOR OASIA/LMOGHTADER
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, SAN FRANCISCO FRB/TERESA CURRAN, AND NEW YORK FRB MARI
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SUBJECT: Taipei Economic Brief for May 2007

11. This cable summarizes selected May 2007 economic events in Taiwan:

- Economic Growth
- Economic Prospects
- High-speed Rail Impact
- Taiwan and Japan Amend Aviation Agreement
- New Cross-Strait Operations
- Free Trade Agreement (FTA)
- Ban on Bank Branches Lifted
- Greenhouse Gas Legislation

Taiwan Raises Economic Growth Rates

12. Unexpectedly good trade performance in the first four months has offset the adverse effects of the still pending 2007 central budget causing Taiwan's Directorate General of Budget, Accounting and Statistics (DGBAS) to raise its estimate of real Q1 GDP growth to 4.15%. The manufacturing sector reported growth accelerated from 0.5% in Q4 of 2006 to 1.1% in Q1 and 3.1% in April of 2007. Higher real estate and stock prices have contributed to a "wealth effect" and faster growth in retail sales and private consumption. Inflation is below one percent, and the unemployment rate of 3.8% is the lowest over the past six years.

Bright Economic Prospects

13. The DGBAS expects regional trade will sustain growth of Taiwan's exports throughout 2007, despite signs of economic slowdown in the United States. (East Asia currently absorbs about 65% of Taiwan's total exports.) According to a Taiwan Institute of Economic Research (TIER) survey in May, half of manufacturing firms

anticipate better performance in the next six months, while only 14% predict worse performance. Resolution of card debt problems and a decline in unemployment will drive up private consumption growth in 2007 to 3.0% from 1.5% in 2006, according to DGBAS. The DGBAS expects Taiwan's real GDP growth will accelerate to 4.7% in Q4.

Impact of High-speed Rail

14. Taiwan's high-speed rail, which began operation in January, has cut travel time between major cities in Taiwan, drawn Taiwan's four science industrial parks closer, and stimulated development of tourism by permitting one-day trips. However, the high-speed rail has hurt the existing transportation businesses. Revenue of Taipei-Kaohsiung passenger buses has declined by one-third. The Taiwan Railway Administration reported a 5.6% decline in its non-high-speed service revenue in March. Airlines companies have suspended all flights between Taipei and Taichung and have reduced fares and flights between Taipei and Kaohsiung.

Taiwan and Japan Amend Aviation Agreement

15. On May 21, 2007, Taiwan's Civil Aeronautics Administration (CAA) confirmed that Taiwan and Japan amended their bilateral aviation agreement in mid-March. According to the amendment, Japan will open charter flights to all Taiwan air carriers, and Taiwan will allow Japan's Nippon Cargo Airlines to enter Taiwan's air cargo market. Japan insisted that Taiwan open its air cargo market in exchange for lifting restrictions on charter flights. Taiwan agreed because of strong need among Taiwan's smaller carriers to alleviate the impact from Taiwan's high-speed rail. Taiwan's larger carriers, China Airlines and EVA, opposed the amendment.

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New Cross-Strait Operations

16. A Taiwan ship named the Chuan Fu Lun became the first vessel to sail directly from PRC-controlled Fuzhou to Taiwan-controlled Penghu via the expanded "mini-links." It arrived in Penghu with 1,600 tons of gravel on May 14, 2007. Previously, the mini-links connected the Taiwan-controlled islands of Kinmen and Matsu, which lie just off the coast of China, with the ports of Xiamen and Fuzhou in Fujian Province. In March, Taiwan approved the expansion of the mini-links to include the Penghu Islands, which are much closer to Taiwan. Starting on April 1, 2007, Penghu residents are permitted to travel to China using the existing ferry service from Kinmen. Although cargo ships are permitted to sail directly to and from Penghu, passenger ships are allowed only on a case-by-case basis and then only with a stop in Kinmen.

Free Trade Agreement (FTA)

17. Taiwan signed a multi-lateral FTA with El Salvador and Honduras on May 7. Taiwan already has signed bilateral FTAs with Panama, Guatemala and Nicaragua.

Ban on Bank Branches Lifted

18. On May 11, the Financial Supervisory Commission (FSC) lifted a six-year ban on the establishment of branches by banks. Banks meeting FSC criteria will be permitted to establish up to three new branches a year. The criteria include a minimum capital adequacy ratio of 10%, a maximum non-performing loan (NPL) ratio of 2%, a minimum bad debt/reserve ratio of 50%, and a minimum 5% return on net worth over the past three years. Few Taiwan banks meet these criteria.

Greenhouse Gas Reduction Legislation

19. On May 7, the Legislative Yuan (LY) Environmental Protection

Committee completed its first reading of the proposed Greenhouse Gas Emission Reduction Law. The bill seeks to keep annual greenhouse gas emissions during 2025-2030 at the 2005 level. The Chen Administration opposes the bill which will prevent Taiwan from implementing major industrial projects, including a large steel mill planned by Formosa Plastic Group and a naphtha cracker project proposed by the state-owned CPC (Taiwan).

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